Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
2000 Biennial Regulatory Review	)	CC Docket No. 00-175
Separate Affiliate Requirements of	)	
Section 64.1903 of the Commission's Rules	)	

JOINT COMMENTS OF THE

INDEPENDENT TELEPHONE & TELECOMMUNICATIONS ALLIANCE

AND OF THE

ORGANIZATION FOR THE PROMOTION AND ADVANCEMENT OF SMALL TELECOMMUNICATIONS COMPANIES

THE INDEPENDENT TELEPHONE &
TELECOMMUNICATIONS ALLIANCE

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Summary

The separate affiliate requirements under review here currently burden independent (non-BOC) ILECs. The Independent Telephone & Telecommunications Alliance (ITTA) and the Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO) respectively represent the substantial majority of midsize and rural telephone incumbent carriers affected by this rule. They have joined in these Comments to emphasize to the Commission the need for less regulation and regulatory intrusion into the marketplace – a need exemplified by both the lack of necessity for the separate affiliate rule and by the implicit attitude in the Notice toward deregulation.

The Notice reflects, and therefore perpetuates, an *a priori* bias favoring regulation. Its formulation of the issues is pro-regulatory, presuming that the existing separate affiliate rule produces benefits, that those benefits outweigh any costs which may be imposed by the rule, that change to the rule will require other rules, and that the Commission should consider expanding the rules in the manner of § 272 (which expressly applies only to BOC companies). All of this, as the current Chairman of the Commission has described, is reflective of a pro-regulatory bias – a habit of approach which seeks to forestall possible, but undemonstrated harms, through direct regulatory intervention in the marketplace. The cost of this intervention, in the Commission's prior words, is a loss of market "dynamism" which works, in the Chairman's words, to "handicap the market and postpone the arrival of competition and consumer choice."

The separate affiliate rule, as review of prior Commission orders reveals, is a product of this psychological bias toward regulation. The Commission initially

adopted non-dominant treatment for non-BOC ILECs without any separate affiliate requirements. The current rule was an afterthought, resulting not from a record of complaints and misconduct (the record showed an absence of such) but rather from "concerns" for future conduct which might or might not transpire. In adopting this rule, the Commission conducted no studies and required none of the detailed data now requested in the Notice to undo the rule. In every material respect, the separate affiliate requirement is the product of the kind of thinking which impedes market activity and runs counter to clear Congressional directives for deregulation.

Even when measured against the pro-regulatory standards of the Notice, the rule is unjustified. The notion that independent ILECs exercise monopoly control over local exchange and exchange access facilities is belied by subsequent events. The 1996 Act, and the Commission's many rules and interpretations since enactment, have been adopted precisely "in order to break the incumbents' control over local facilities." Interconnection, unbundled network element access, resale, and termination of all local franchises and legal monopolies have nullified any absolute control ILECs may once have had over their networks. They cannot cross-subsidize, discriminate in access, or engage in price squeezes either as a practicable matter or a legal one, without clear risk of detection under the large array of state and federal rules and remedial processes that exist independently of the separate affiliate rule. That rule, to the contrary, is wholly unnecessary and merely interferes with Congressional desires to "to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans…."

An invocation of § 272 requirements has even less foundation (this section expressly only applied to BOCs) and merely gives further evidence of the pro-regulatory bias at work in this proceeding.

ITTA and OPASTCO urge the Commission to seize this opportunity to abandon the historical path of regulation in ever-increasing numbers and ever-increasing particularity. The separate affiliate rule in question adds nothing to the Commission's powers not already present in law**.** Terminating that requirement will not terminate the Commission's authority over independent ILECs. It will not terminate the positive requirements of the statutes regarding just, reasonable and non-discriminatory rates. Nor will it terminate the Commission's ability to enforce those statutes. It will not suspend federal antitrust laws or state consumer protection statutes.

What terminating the existing rule will do is make a start on reducing the amount of federal micromanagement now afflicting the interstate marketplace. It will add incremental importance to market demands, and decrease the importance of regulatory demands by that same increment. This may be the primary impediment to getting the Commission to terminate the rule, but it is an impediment that must be overcome – the sooner, the better for the Commission, the carriers, and the consumer.

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1. Introduction

In addressing the inherent limitations of regulation, the Independent Telephone & Telecommunications Alliance (ITTA) recently drew attention to a major impediment affecting the transition to competitive markets:

> There is a very strong tendency for government agencies imbued with the traditional public utility regulatory philosophy to carry over into putatively competitive areas the same tendency to assume direct responsibility for the outcome, by micromanaging and handicapping the competitive process itself, in ways that threaten to jeopardize the very benefits that competition would otherwise bring to consumers.[1]

[1] Kahn, Alfred E., "Deregulation: Micromanaging the Entry and Survival of Competitors," The Edison Electric Institute, Washington, D.C. (February, 1998) at 7 ("Kahn").

This tendency is at work in this proceeding, as evidenced by various portions of the Notice of Proposed Rulemaking.[2] The proper consideration of the separate affiliate rule should comprehend not only the specific issues directly raised in the Notice, but as well the unraised issue of the impact of regulatory tendencies in the decision to terminate regulatory rules.

ITTA, on behalf of its midsize company members,[3] and the Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO),[4] on behalf of its rural telephone companies, address both sets of issues in these Joint Comments, beginning with an analysis of the problems engendered by a pro-regulatory philosophy. ITTA and OPASTCO next demonstrate that the separate affiliate rule, itself, was the product of such a philosophy, rather than of any factual record of ILEC misconduct. Therefore, continuation of the rule disserves the public interest by continuing the adverse public interest consequences of over-regulation. The Joint Comments then consider whether the separate affiliate rule is warranted under any applicable standard, including the pro-regulatory one apparent in the Notice. ITTA and OPASTCO also review the marginal relevance of Section 272 to these proceedings. The Joint Comments conclude by supporting the Commission's apparent willingness to depart from its recent historical tendency toward increased regulation, in favor of "ceding control to the marketplace."

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[2] *In the Matter of 2000 Biennial Regulatory Review Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules,* Notice of Proposed Rulemaking, CC Docket No. 00-175, FCC 01-261 (released September 14, 2001) (hereinafter "NPRM" or "Notice").

[3] ITTA represents independent incumbent local exchange companies which have "fewer than 2 percent of the Nation's subscriber lines installed in the aggregate nationwide." See 47 U.S.C. § 251(f)(2).

[4] OPASTCO is a national trade association representing over 500 small incumbent local exchange carriers serving rural areas of the United States. All of OPASTCO's members are rural telephone companies as defined in 47 U.S.C. Section 153(37).

By starting with the fundamental frame of reference for evaluating deregulation, ITTA and OPASTCO seek to foster a different attitude toward regulation in this proceeding and to extend that new attitude to other deregulatory proceedings. The goal is to positively influence future Commission policy-making in the direction of congressional deregulatory directives, thereby promoting the benefits of the "pro-competitive, deregulatory national policy framework" which underlies the 1996 Act. In support of this analysis, ITTA and OPASTCO respectfully offer the following Joint Comments for Commission consideration.

2. The Notice reflects an inappropriate perspective on deregulation.

The 1996 Act manifests the affirmative congressional policy favoring deregulation and infuses the Communications Act of 1934 with authority to carry out that directive. Proceeding from the preamble,[5] the Act supports deregulation by requiring the Commission to periodically reconsider its own regulations,[6] to consider at any time the petition of a telecommunications carrier or class of telecommunications carriers for forbearance,[7] and to utilize forbearance to encourage the deployment of advanced telecommunications.[8]

The exercise of these powers, however, has been frustrated by the institutional "tendency" toward regulation and regulatory thinking pointed out above. The Notice itself reflects the extension of this problem to this proceeding, as for example in the

[5] Preamble, Joint Explanatory Statement of the Committee of Conference, Conference Report S. 652 (January 31, 1996).
[6] 47 U.S.C. § 11.
[7] 47 U.S.C. § 10.
[8] Section 706, Telecommunications Act of 1996 (not amending the Communications Act of 1934).

formulation of the objectives of the proceeding. If one compares the first invitation in the Notice…

> In this NPRM, we invite interested parties to comment on whether or not the benefits of the separate affiliate requirements for facilities-based providers continue to outweigh the costs and whether or not there are alternative safeguards that are as effective but impose fewer regulatory costs.[9]

with a subsequent invitation…

> In this proceeding, we invite interested parties to comment on whether application of the separate affiliate requirement for incumbent independent LECs serves the public interest.[10]

he or she can discern the patently pro-regulatory bent of the former. The first formulation presumes benefits from a regulatory rule, presumes that such benefits have outweighed the regulatory costs engendered (whatever they may be), and presumes the rule to be exchangeable only for other (if less costly) rules. The second formulation asks, instead, a neutral question: Does the rule serve the public interest?

The causes and effects of this apparent pro-regulatory bias have been cogently identified and analyzed by a current member of the Commission. The source of the problem is agency habit – the "tendency" to assume direct responsibility for outcomes, rather than letting market dynamics dictate the results:

> [O]ne of the biggest obstacles to policymakers truly promoting competition, deregulation and innovation is not legal, economic or technological; rather, it is psychological. One reason I believe that policymakers find it difficult, even after setting appropriate ground rules, to allow the market to run its course, is, ironically, their fear of ceding control to the marketplace. The 1996 Act commands policymakers and industry to move away from the monopoly-oriented, over-regulatory origins of communications policy and toward a world in which the market,

[9] Notice at ¶ 1.
[10] Notice at ¶ 8.

> rather than bureaucracy, determines how communications resources should be utilized. Yet, so often, we cannot actually bring ourselves to let go, to jump off our regulatory perch.[11]

The consequence of this bias is active and persistent intervention in markets, frequently on a prospective or prophylactic basis, which intervention impedes competitive development:

> Although these fears [arising from the risks of a free market] are not inconsequential, however, they nearly always are overstated and tend to paralyze us from taking action that would allow markets to flourish and competition to grow. Instead, we speculate about possible anticompetitive effects and then adopt policies intended to protect new entrants and consumers from them. Rather than protect these interests, however, we more often, in practical effect, handicap the market and postpone the arrival of competition and consumer choice.[12]

This is not an idle debate over regulatory philosophies -- a debate which Congress, in any event, has pre-empted by passing the deregulatory provisions of the 1996 Act cited above. It goes to the heart of how the Commission looks at its own duties and powers, and how it manifests the results of that introspection by extending or reducing regulation. The prior insights of the current Commission Chairman, along with the similar views of others noted herein, identify the cause and the adverse effects which a pro-regulatory bias has on the public interest. This bias is the correct place to begin the analysis of what to do about the separate affiliate rule.

3. The separate affiliate rule reflects and perpetuates the adverse effects of an inappropriate perspective on deregulation.

[11] "Working Toward Independents' Day," Remarks of Commissioner Michael K. Powell, Federal Communications Commission, Before the Independent Telephone Pioneer Association, Washington, D.C. (May 7, 1998) at 3.
[12] Commissioner Powell's Remarks of May 7, 1998 at 3.

The separate affiliate rule exemplifies the pattern of regulatory reluctance assayed above. In origin, the rule rests not on historical conduct or on record evidence, but rather on speculative "concerns" for possible future conduct. To protect against a conceptual harm, the Commission has imposed a policy of preventive detention on all independent ILECs. This policy saddles them with admitted administrative costs and inefficiencies not borne by others against whom they must compete. It thereby postpones the arrival of true competition in the marketplace by handicapping one group of participants to the competitive benefit of other groups. The existence of such rules ignores, to the detriment of the public, the existence of underlying enforcement authority fully adequate to monitor, to analyze, and to correct misconduct in the unlikely event such conduct actually occurs.

Initially, in the Fourth Report and Order, the Commission classified "interexchange carriers affiliated with exchange telephone companies" as non-dominant and imposed no separate affiliate rules.[13] The Commission found this unencumbered classification warranted by the record in the proceeding:

> Exchange telephone companies have the potential to increase competition in interexchange, interstate telecommunications services. However, it is possible that an exchange telephone company could utilize unequal interconnection arrangements to gain market power in interstate services of its affiliate. We will scrutinize exchange interconnection arrangements for discrimination through our examination of exchange access tariffs and our complaint process; by this decision, we do not lessen our regulatory scrutiny of possible abuses of an exchange telephone company's local exchange facilities.[14]

[13] *In the Matter of Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor,* Fourth Report and Order, CC Docket No. 79-252, 95 F.C.C.2d 554, at ¶5 ("Fourth Report and Order").
[14] *Id.* at ¶ 32.

In adopting an approach entailing no separate affiliate rules, the Commission was not blind to the market power implications of local exchange facilities. Likewise, it recognized the possibility of abuse arising from access to and use of such facilities. But the Commission also gauged the minimal nature of the problem, and was well aware of its residual power and authority under existing rules to detect and punish any such abuses.

> Even if we erred in our analysis of market power, by classifying these carriers as non-dominant we are not removing fully our regulatory checks on their prices. …While our analysis leads us to doubt that the carriers covered by this proceeding would charge unlawful rates, we will remain sensitive to the concerns and investigate complaints expeditiously. Also, we would quickly initiate an investigation against rates and practices which appear unjust and unreasonable. However, we do not believe that the limited potential problems warrant imposing a heavy regulatory burden on these carriers with consequent costs and inefficiencies. If necessary, we can re-impose the tariffing and facilities-authorization requirements on a class of carriers we find non-dominant in this Order.[15]

The Commission acknowledged that regulation imposes burdens, often asymmetrical in nature ("*these* carriers"). But rather than generate further burdens through new rules intended to forestall "limited potential problems," the Commission determined to rely on its existing, comprehensive authority to police and enforce proper market conduct. The velvet glove which this relatively mild deregulation represented sheathed a firmly mailed fist of enforcement capabilities, backed by the expressed willingness of the agency to exercise that capability.

> We will continue to apply full Title II regulatory scrutiny to exchange access tariffs. To ensure ratepayers are not harmed, we will consider carefully complaints regarding rates for interstate services charged by

[15] *Id.* at ¶ 33 (emphasis added).

> affiliates of exchange telephone companies utilizing premium interconnections from those companies.[16]

As the Commission recognized, the true source of deterrence in this situation arises from the statutory enforcement powers granted by the Telecommunications Act. In light of this, the limited deregulation being implemented was backed by the clear threat of detection, correction, and punishment under Title II for any subsequent unlawful conduct. This deterrence was neither created nor sustained by a separate affiliate rule, since none was adopted.

This approach, regrettably, proved short-lived. The Commission recanted in the Fifth Report and Order[17] and for the first time introduced the separate affiliate burdens now codified in the Commission's Rules at §64.1901-03.[18] The Commission cited no change in fact warranting this subsequent reconsideration. The Order, instead, ascribed the origins of the new rules to "concerns" expressed in the preceding Fourth Report and Order:

> Nevertheless, our concerns about cost-shifting and anticompetitive conduct by exchange telephone companies led us to require in the Fourth Report and Order a certain amount of separation between exchange telephone companies and affiliated interexchange carriers which are regulated as nondominant. In response to informal requests for clarification, these standards are explained in the next paragraph.[19]

But the Fourth Report and Order reflects no analysis of "cost-shifting and anticompetitive conduct" problems, nor does it discuss any specifically required conditions of separation

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[16] *Id.* at ¶ 32.
[17] *In the Matter of Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor,* Fifth Report and Order, CC Docket No. 79-252, 98 F.C.C. 2d 1191 (1984) ("Fifth Report and Order").
[18] *See* 47 C.F.R. §64.1903 which requires IXC affiliates of ILECs to maintain separate books of account, prohibits joint ownership of switching and transmission facilities, requires inter-affiliate transactions to be based on tariff or unbundled network element (UNE) terms and conditions, and requires the separate incorporation of the affiliate.

between exchange telephone companies and affiliated interexchange carriers. The Fifth Report and Order, separately, does not refer to any evidential record of problems or abuse by the independent ILECs to support the new rule. Indeed, the Order states to the contrary that:

> [D]uring the nine months that facilities-owning interexchange carriers affiliated with exchange telephone companies…have been subject to streamlined regulation, the Commission has received no petitions opposing their tariffs or formal complaints against them.[20]

The source and nature of the "informal requests" for clarification occasioning the new rule also remain undisclosed in the Order. The only thing certain is that the new regulation rested on speculative concerns about the potential for anticompetitive conduct, and not on record evidence of improper activities.

Since there was no evidence of abusive conduct prior to rule implementation, the separate affiliate rule can hardly be credited with having solved a problem. Rather than an act of enforcement, the separate affiliate rule represents the tendency to "speculate about possible anti-competitive effects and then adopt policies" warned against by the Chairman and others. The Notice replicates this inappropriate perspective by an incessant focus on the speculative concern for "the ability and incentive of incumbent independent LECs to engage in discriminatory conduct."[21]

The problems with this are the ones described in detail above: regulatory micromanagement of outcomes; handicapping of certain market participants; interference with market operations; implementation of speculative policies; and diminution of the public interest. Congress has already determined that policy will proceed in the direction

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[19] Fifth Report and Order. at ¶ 8.
[20] *Id.* at ¶ 10.

of deregulation, because competition and deregulation are most likely "to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans…."[22] Since Congress gets to make policy determinations, resistance to that policy arising from the habits of regulation only serves to prevent competitors and competition from reaching full potential, thus inflicting adverse impacts on the public interest.

4. Even under an inappropriate regulatory perspective, the separate affiliate rule is unjustified.

As the Fifth Report and Order admits, *supra,* the separate affiliate rule is based on speculative "concerns" for potential anticompetitive conduct, and does not rest on a factual record of such conduct. As also discussed above, ITTA and OPASTCO believe this is an improper basis, both for the separate affiliate rule itself and for any evaluation of that rule. We recognize, however, that the historical perspective may nonetheless be applied in this proceeding. Even if it is, the separate affiliate rule still lacks adequate justification, as the discussion below points out. In presenting this discussion, ITTA and OPASTCO do not abandon their position that this historical, pro-regulatory perspective is both contrary to the directives of Congress and inimical to the public interest.

a. Having been eroded by subsequent events, "bottleneck facilities" and derivative arguments do not sustain continued imposition of the separate affiliate rule.

The Notice recites three anticompetitive concerns to justify imposition of the separate affiliate rule: The potentials for cost misallocation, for unlawful discrimination, and for

[21] Notice at ¶ 4, 5, 13, 14, 15, 16, 19, 20, 21, and 22.
[22] Preamble, Joint Explanatory Statement of the Committee of Conference, Conference Report S. 652 (January 31, 1996).

effectuation of a price squeeze.[23] As the LEC Classification Order notes, these concerns emanate from the underlying belief that independent LECs control "bottleneck facilities":[24]

> We conclude, however, that the independent LECs' control of local exchange and exchange access facilities potentially enables them to misallocate costs from their in-region, interexchange services, discriminate against rivals of their interLATA affiliates, and engage in other anticompetitive conduct.[25]

The basis for this belief that independent LECs exercise sole control over bottleneck facilities has been substantially eroded by the many changes transpiring since this rationale was initially advanced.

Adoption and implementation of Section 251(c) of the 1996 Act, for example, has opened ILEC facilities to interconnection and use by any telecommunications carrier for the provision of any telecommunications service.[26] The primary purpose of this section, as the Commission has noted, was to offset any competitive advantage arising from the bottleneck nature of the facilities:

> Central to the new statutory scheme is section 251 of the Act, which seeks generally to reduce inherent economic and operational advantages possessed by incumbent local exchange carriers. Toward this end, section 251 imposes specific market-opening mechanisms, such as mandatory

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[23] Notice at ¶ 4. *See also, In the Matter of Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area,* Second Report and Order, CC Docket No. 96-149, 1997 WL 193831 (1997) at ¶¶ 158-161 ("LEC Reclassification Order").
[24] LEC Reclassification Order at ¶ 158.
[25] *Id.* at ¶ 7.
[26] *See* 47 U.S.C. § 251(c)(1)-(3). As noted, *infra*, Congress has established additional requirements with respect to the application of these provisions for the companies represented by ITTA and OPASTCO. *See* 47 U.S.C. § 251(f)(1) and (2).

> interconnection, unbundling, and resale requirements on incumbent LECs, in order to break the incumbents' control over local facilities.[27]

ITTA's member companies currently have entered into a larger number of interconnection agreements and resale agreements, and no longer exercise anything approaching absolute control over their own facilities. This absence of bottleneck control is further reinforced by Section 253's termination of all exclusive "franchises" [28] for ILEC service areas and the prohibition on state-authored barriers to competitive entry in the future. The fount of the concerns for misallocation, discrimination, and price squeeze, thus, has been substantially dried up by the 1996 Act.

As to the derivative issue of cost misallocation, the Commission itself has noted in other proceedings that mere proper cost allocation remains a basic problem for regulators.[29] The requirement for separate books does not address this prior problem of how to determine proper allocations, much less solve the problem of improper ones.

The concerns for misallocation also fail to explore the implicit parallel assumption that costs thus improperly misallocated will be collected "from subscribers to the independent LEC's local exchange and exchange access services."[30] Unless collected from such end-users, no incentive to misallocate costs exists. ITTA and OPASTCO assert that such collection is unlikely, for two reasons.

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[27] *In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996,* Third Report and Order and Fourth Further Notice of proposed Rulemaking, CC Docket No. 96-98, FCC 9-238 (1999) at ¶ 3 (emphasis added).

[28] *See* First Report and Order at ¶ 65: " The independent telephone industry consists of approximately 1500 carriers that offer both local and interstate services. As franchise holders in exchange areas these carriers possess control of essential facilities."

[29] *See In the Matter of Developing a Unified Intercarrier Compensation Regime,* Notice of Proposed Rulemaking, CC Docket No. 01-92, FCC 01-132 (released April 27, 2001) at ¶ 34: "Certain types of regulatory decisions are especially problematic –- e.g., the allocation of common costs among services or users."

[30] LEC Classification Order at ¶159.

First, the misallocation concern presumes that state agencies (for local exchange and state access) and the Commission (for federal access) will be unable to detect the improper cost allocation from the rate-making side of the transaction. Given the rigorous examination to which rates are subjected at the state and federal levels (whether in prescriptive or complaint proceedings), this assumption seems doubtful. Second, local exchange and exchange access have been demonopolized in law and have been subjected to ever-expanding facilities-based competition from cellular, PCS, wireless broadband, VoIP network and CATV providers. These networks have created substantial alternatives to local wireline for both local exchange and access services, providing consumers with plausible substitutes for wireline services over-priced because of cross-subsidization.

Similarly, there is little plausibility in the concern for potential discrimination in competitor access to or quality of service obtained from independent LEC facilities. The plethora of rules associated with the interconnection provisions of the 1996 Act, discussed above, requires that access be provided in a non-discriminatory fashion, at a level of quality at least equal to that provided anyone else:

> We conclude that the equal in quality standard of section 251(c)(2)(C) requires an incumbent LEC to provide interconnection between its network and that of a requesting carrier at a level of quality that is indistinguishable from that which the incumbent provides itself, a subsidiary, an affiliate, or any other party.[31]

The Commission originally found this concern manageable without prophylactic rules, back in 1983:

> We will scrutinize exchange interconnection arrangements for discrimination through our examination of exchange access tariffs and our

[31] *In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996,* First Report and Order, 11 FCC Rcd 15499 (1996) at ¶224.

> complaint process; by this decision, we do not lessen our regulatory scrutiny of possible abuses of an exchange telephone company's local exchange facilities.[32]

The changes in law since then, particularly Sections 251 and 252, have only further reduced the ability of LECs to discriminate in access to local facilities, thereby underscoring the superfluity of the separate affiliate rule

These changes also practicably eliminate the ability of any LEC to engage in a price squeeze. Unless it can deny access to a necessary input, or improperly cross-subsidize the pricing of that input to an affiliate, or improperly over-charge a competitor for that input, a LEC cannot effectuate a price squeeze. But regulatory scrutiny of access charge and end-user rates, regulatory pricing and implementation of interconnection and unbundled network element access, regulatory maintenance of basic equal access rules, and regulatory power to review, correct and punish improper conduct under Title II all serve to remove any basis for possible price squeezes with respect to local exchange facilities.

All of these regulatory capabilities and powers exist independent of the separate affiliate rule in issue. None of them would be adversely impacted by the rule's demise. Collectively, they severely limit the ability of any independent ILEC to engage in cost misallocation, discrimination, or price squeeze activities, the fear of which animated the creation of the separate affiliate rule.

b. The Commission has already determined that rules such as the separate affiliate requirement impose significant regulatory and economic costs.

[32] Fourth Report and Order at ¶ 32.

The Notice asks "for specific, detailed information rather than speculative statements about regulatory costs and/or the potential for anti-competitive behavior."[33] It is, of course, solely upon such speculative statements about the potential for anticompetitive conduct that the separate affiliate rule was erected. The Commission noticeably did not seek such specific, detailed information when it adopted the rule. There is, thus, the further irony of requiring factual proof from independent ILECs to terminate a rule implemented without benefit of such factual proof.

Quantification of specific regulatory costs arising from or in connection with the special affiliate rule is both difficult and expensive. This is in part a function of the Commission's mandated cost accounting rules, which are not conducive to the identification, retention and analysis of such information. In part, also, this is because the separate affiliate rule is but one of many regulatory burdens imposed on independent ILECs; determining the incremental costs of each such rule requires some acceptable methodology and the time, personnel, and resources to effectuate it.

The existence and materiality of such costs, however, can be demonstrated in other ways. In a prior order, the Commission has already recognized the kinds of costs which regulation imposes:

> Second, enforcement of a system of regulation of business conduct imposes costs. These costs can be identified in two classes. There are the less significant administrative costs of compiling, maintaining, and distributing information necessary to comply with agency licensing and reporting requirements.[34] More significant costs, however, are inflicted on society by the loss of dynamism which can result from regulation.

[33] Notice at ¶ 14.
[34] In the timeframe of this observation, pre-1996 Act, such costs might have seemed less important. In the post-Act competitive period, no cost is unimportant, particularly when a competitor can escape such.

> Indeed, regulation sometimes creates what can only be called perverse incentives for the regulated firms.[35]

In the Fourth Report and Order the Commission again supported non-dominant treatment of independent ILEC LD affiliates without the need for a separate affiliate requirement, basing its decision on "removing costly regulatory burdens" and avoiding "inefficiencies and imposing costs on carriers and consumers without offsetting benefits to consumers."[36] The Commission concluded that;

> [W]e do not believe that the limited potential problems warrant imposing a heavy regulatory burden on these carriers with consequent costs and inefficiencies.[37]

In the present matter, the Commission is aware from the Second Reconsideration Order that some --

> …evidence in the current record indicates that the Fifth Report and Order requirements may have disparate impact on rural and mid-sized independent LECs. [Citation omitted] For example, petitioners present evidence suggesting that the costs of compliance with the separate legal entity requirement may be more burdensome for smaller independent LECs…."[38]

Similarly, the loss of dynamism in the marketplace (already acknowledged by the Commission) is difficult to quantify. Its existence, though, is generally recognized:

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[35] First Report and Order at ¶ 11. ITTA and OPASTCO note that perverse incentives are created for competitors, as well. *See In the Matter of Developing a Unified Intercarrier Compensation Regime,* CC Docket No. 01-92, FCC 01-132 (2001) at ¶11: "One source of regulatory arbitrage appears to be inefficient reciprocal compensation rates….As a result of these inefficient terminations charges, certain CLECs appear to have targeted customers that primarily or solely receive traffic, particularly ISPs, in order to become net recipients of local traffic."
[36] Fourth Report and Order at ¶¶ 1, 2.
[37] Fourth Report and Order at ¶ 33.
[38] *In the Matter of Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area,* Second Order on Reconsideration and Memorandum Opinion and Order, 1999 WL 439663 (1999) at ¶18 ("Second Reconsideration Order").

> [C]ompetition policy must distinguish competitive advantages arising from a position as a franchised monopoloist that may be characterized as merely strategic – such as control over access to essential facilities – from those that flow from superior efficiencies, arising primarily from *economies of scale, scope and experience.* The efficiency advantages are legitimate and promote consumer welfare; denying incumbent companies the ability to take advantage of them in unregulated markets is anti-competitive.
>
> Any attempt to deny incumbent utility companies the benefit of or handicap them in exploiting genuine efficiency advantages threatens to *suppress* competition and denies consumers its full benefits.[39]

The Commission said as much in the Fifth Report and Order when it stated, "To the extent there may be efficiencies within [carriers'] structures, they should not be precluded from capitalizing on them where countervailing regulatory condsiderations do not demand stringent separation."[40]

Non-ILECs, also, do not appear to find the costs related to regulatory structures immaterial, since they generally have not voluntarily adopted regulatory regimes. Whatever the specific dollar level of these costs, they are real and, as discussed in the next sections, unwarranted -- alternatives to the separate affiliate rule are available which produce the benefits ascribed to the rule, without the added layer of costs arising from that rule.

c. The benefits from the separate affiliate rule are minimal or illusory, at best.

The magnitude of the cost burden imposed by such regulations contrasts with the minimal nature of the benefits which purport to flow therefrom. In the case of the separate affiliate rule, the benefits appear to derive from the deterrent effect which imposition of this rule was thought to generate.

[39] Kahn at 7, 8. As noted previously, independent ILECs no longer enjoy franchises, nor do they exercise sole control of their exchange and exchange access facilities.

A review of the antecedents set out in the Notice does not confirm any need for such deterrence. The Notice relies for justification upon specific paragraphs of the Second Reconsideration Order, [41] which in turn rely upon the Fifth Report and Order.[42] The Fifth Report and Order, however, devotes substantial space to describing the adequacy of extant regulatory powers to deter and detect improper conduct between ILECs and their interstate, interexchange affiliates. The Order makes the straight-forward assertion that:

> [W]e have regulatory tools to inhibit cost-shifting and anti-competitive conduct by exchange telephone companies.[43]

The Order then proceeds to detail the Commission's ability to require interconnection on just, reasonable, and non-discriminatory terms and conditions; to fully require and regulate exchange access tariffs; to prevent unreasonable bundling of exchange and interexchange services; to prevent unreasonable discrimination in favor of any interexchange carrier; to investigate switched and special access tariffs; to prosecute complaint processes; and to correct any abuses through the imposition of re-tariffing requirements or "other conditions."[44]

Given this substantial array of powers, the deterrent benefits of the separate affiliate rule appear minimal, at best. Indeed, the Commission devotes little explanation to the reasons why, in the face of its existing powers, the rule was necessary at all. The sole basis, as described in Section 3, *supra,* is the asserted (but difficult to find) "concerns about cost-shifting and anticompetitive conduct" originating in the Fourth Report and Order. In neither Order did the Commission quantify the benefits of the separate affiliate

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[40] Fifth Report and Order at ¶ 8 (citing from the Second Computer Inquiry).
[41] Second Reconsideration Order at ¶¶ 2 and 17.
[42] *Id.* at ¶ 5.
[43] Fifth Report and Order at ¶ 7(emphasis added).

rule, and certainly did not engage in the "specific, detailed" analysis which the Notice now applies to the question of regulatory costs.

ITTA and OPASTCO concur with the earlier Commission view that deterrence arises from the statutory provisions of Title II, and that existing regulatory powers – now greatly enhanced post-1996 by the changes in the Telecommunications Act – are more than adequate to effect compliance by independent ILECs. The separate affiliate rule adds nothing demonstrable to these existing powers, and merely increases the costs which plainly and admittedly arise from such regulatory impositions.

5. Satisfactory alternatives for protecting the public interest already exist.

Unlike the Fourth Report and Order, the Notice fails to acknowledge and discuss the availability of underlying statutory authority in the Communications Act to detect, correct, and penalize improper activities should they actually occur.[45] This failure presents a distinct contrast to the Commission's earlier acknowledgment of the vitality and importance of these provisions:

> We are confident that market forces, our complaint process, and our ability to re-impose tariff-filing and facilities authorization requirements are sufficient to protect the public interest regarding carriers treated by forbearance."[46]

Reliance upon such powers in no way amounts to an abandonment of statutory requirements:

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[44] *Id*.
[45] Neither the text nor the associated footnotes of the Notice refer at any point to the residual statutory authority set out, e.g., in Sections 202 and 204 – 209. Section 201 is referred to only once, in n. 24 of the Notice, and there only to support the proposition that the Commission can impose additional regulation on independent ILECs. *See* Notice at ¶ 12.
[46] Fourth Report and Order at ¶37.

> We have not eliminated the requirements that rates be just, reasonable, and non-discriminatory. We have merely changed the method by which we will police that requirement.[47]

Similarly, the Commission felt strongly about its residual powers when it released AT&T from dominant carrier regulation:

> Declaring AT&T non-dominant will not remove AT&T from regulation. Like other non-dominant carriers, AT&T will still be subject to regulation under Title II of the Act. Specifically, non-dominant carriers are required to offer interstate services under rates, terms and conditions that are just, reasonable and not unduly discriminatory. (Sections 201-202), and non-dominant carriers are subject to the Commission's complaint process (Section 206-209).[48]

The basic problem would seem less an absence of effective alternatives, and more the tendency to regulate, as discussed above. The separate affiliate rule does not arise from the lack of effective enforcement powers, but rather from the Commission's unwillingness to cede control to the marketplace and to utilize those powers in an enforcement capacity.

6. Section 272 considerations support termination of the separate affiliate rule as to small and midsize companies.

The Notice raises various issues concerning the relevance of Section 272 in this docket.[49] The point of this is unclear. Section 272 of the 1996 Act reflects a lengthy legislative laundry list directed to separate affiliate requirements for manufacturing, origination of intraLATA telecommunications services, intraLATA information services, joint marketing, sales of affiliate services, and a number of other matters.[50] The

[47] First Report and Order at ¶ 6.
[48] *In the Matter of Motion of AT&T Corp. to be Classified as a Non-Dominant Carrier,* Order, CC Docket No. 79-252, FCC 95-427 (1995) at ¶ 13.
[49] Notice at ¶¶ 3 and 12.
[50] *See* 47 U.S.C. § 272(a)-(h).

introduction of this statute into a deregulatory proceeding directed to independent ILECs is mystifying, given that the Notice acknowledges what is plain:

> …Congress itself has recognized that different classes of LECs may require different levels of safeguards and incentives, by mandating the section 272 safeguards only for BOCs…."[51]

The Notice nonetheless asks, "[H]ow should that fact guide our examination of the continued need for the separate affiliate rules under consideration in this proceeding?"[52] ITTA and OPASTCO believe that fact should guide the Commission toward deregulation, beginning with termination of the separate affiliate rule in issue here as to small and midsize companies.

Congress did not authorize or impose any separate affiliate requirements on the independent ILECs, whether like those of the BOCs or otherwise. Congress clearly could have; it specifically did not. The Notice advances no argument that this was an oversight, warranting Commission remedial action action now.

To the contrary, as the Commission states, Congress recognized that non-BOC ILECs required different levels of safeguards and incentives. By "different," Congress did not mean "more burdensome" or "more stringent" than the BOCs'. Congress not only did not impose separate affiliate burdens on non-BOCs, it provided means for relieving small and midsize companies of other burdens it actually did impose.[53] This relief originated in conscious congressional recognition of the differences between small, midsize and larger companies:

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[51] Notice at ¶ 12 (emphasis added). Conversely, the separate affiliate regulation expressly applies only to "an incumbent independent LEC providing in-region, interstate, interexchange services…." 47 C.F.R. § 64.1903(a).
[52] *Id.*
[53] 47 U.S.C. §251(f).

> The Senate intends that the Commission or a State shall, consistent with the protection of consumers and allowing competition, use the authority to provide a level playing field, particularly when a company or carrier to which this subsection applies faces competition from a telecommunications carrier that is a large global or nationwide entity that has financial or technological resources that are significantly greater than the resources of the company or carrier.[54]

The contrast between Section 272 and Section 251(f) highlights the great and persisting divide between BOCs and independent ILECs. The BOCs started with substantial market presence and power in a substantial number of major markets. Independent ILECs, conversely, were the entities potentially threatened by these "large global or nationwide" entities who wielded materially superior resources.[55]

Since enactment of the 1996 laws, the rising tide of consolidation among BOCs and between BOCs and non-local exchange companies has exacerbated this historical disparity in corporate scale and capability, and reinforced the basis for distinct treatment of independent ILECs. Given this increasing disparity in size, resources and markets, attempts to subdivide the independent ILEC companies into categories of small, tiny and teensy move in the wrong direction. The public interest would be better served by reducing regulation on all ILECs, beginning here with the separate affiliate rules pertaining to small and midsize companies.

That Congress contemplated eventual termination of separate affiliate rules, even for the BOCs, is reflected in the statute. Section 272(f)(1) provides for the general

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[54] Joint Explanatory Statement of the Committee of Conference, Conference Report S. 652 at 119 (January 31, 1996).

[55] Congress embedded this distinction between BOCs and independent ILECs in the amendment to Section 153 of the Communications Act which defines Bell operating companies. 47 U.S.C. §153(4). This definition was intended to ensure that all parties might always know who the BOCs and their successors in interest are for purposes of monitoring and enforcing Section 272 and other requirements and duties under the 1996 Act. *See* 47 U.S.C. §153(4)(B): "Includes any successor or assign of any such company that provides wireline telephone exchange service…."

sunsetting of that section's separate affiliate requirements for long distance after three years. The Commission has recognized the import of this provision:

> The inclusion of sunset provisions within the section 272 regulatory scheme indicates a Congressional determination that ultimately most of the legislative safeguards will be unnecessary [citing §272(f)].[56]

The separate affiliate restrictions on BOCs can only be extended by affirmative action of the Commission. Otherwise, they terminate. Since these restrictions were determined to be ultimately unnecessary for the BOCs, similar restrictions would seem even less essential in the case of independent ILECs.

The relevance of section 272 to this proceeding, then, would appear to be negative, if anything. This section highlights the contrast between Congressional treatment of the BOCs (separate affiliate rules adopted) and treatment of the independent ILECs (no separate affiliate rules adopted). Section 272's sunsetting of BOC separate affiliate rules after three years suggests (if anything) that the continued imposition of similar rules on independent ILECs, more than five years after commencement of deregulation under the 1996 Act, is unwarranted.

Given these considerations, the Commission's purpose in asserting a general power to impose separate affiliate rules on independent ILECs is also unclear.[57] The position of ITTA and OPASTCO is that the Commission may indeed have the power to impose rules. What it does not have, in the case of the separate affiliate rule, is a

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[56] *In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934 as amended* and *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area,* Notice of proposed Rulemaking, CC Docket No. 96-149, FCC 96-308 (1996) at ¶9, n. 16.

[57] Notice at ¶ 12: "The Commission has previously found that …the imposition by Congress of section 272 separate affiliate requirements on BOC provision of in-region, interexchange service does not foreclose the Commission from imposing separate affiliate requirements upon incumbent independent LECs under its broad rulemaking authority."

legitimate reason in fact or policy for exercising that power as to independent ILECs. Nothing in or about Section 272 responds to this point. Thus, any application of BOC separate affiliate regulation to independent ILECs on the basis of that BOC-specific section, five years after the 1996 Act and its deregulatory directives, lacks legal foundation and contradicts congressional directives for deregulation. Congress plainly did not want such rules for small and midsize companies back then. Nothing has changed to warrant them now.

7. Conclusion

Change is a hard thing to deal with, no less for commissions than companies. There is at work here an odd parallel between the Commission's reluctant approach to deregulation and the old Bell System's reluctant approach to demonopolization. For years, AT&T maintained an absolutist position with respect to its network: Sole and absolute ownership of facilities; no resale; no shared use; no attachments. As one observer has noted:

> The Bell monopoly grew to gargantuan proportions. Everyone could connect to its networks without discrimination – everyone, that is, except other suppliers and operators of telephones, private switches, public switches, packet-switched data networks, coaxial networks, microwave towers, cellular networks, long-distance trunks, satellite earth stations, and fiber-optic rings. …Bell provided end-to-end service to its customers. That meant lip-to-lip.[58]

AT&T, simply, was unwilling to reduce the scope of its command and control over the telecommunications network. When it did so, it did so grudgingly, in the smallest possible bits and pieces, until the antitrust and *Execunet* cases broke through the resistance.

Five years after the 1996 Act, the Commission similarly continues to resist material reductions in the scope of its regulatory command and control over the telecommunications industry, preferring change in small bits and pieces. Title 47 of the Code of Federal Regulations remains of gargantuan proportions – in fact, is growing. As ITTA recently noted in other proceedings, the past few years have seen a steady increase in both the volume and scope of federal telecommunications regulation, notwithstanding a clear change in congressional policy favoring markets over regulation. Though the

Commission has undeniably considered reform, its efforts to date have produced only miniscule reductions in the scope and volume of regulation.

The time has come for a change in paradigm, and independent ILECs are the place to start.

> I hope that the relatively small size of mid-size independents will allow regulators to become more comfortable with the notion that there may be benefits to replacing prospective regulation with careful monitoring for improper activity, coupled with vigorous enforcement. In addition to eliminating unnecessary regulation, this should provide a way around adopting one-size-fits-all rules that sweep too broadly in terms of the carriers to which such rules apply.[59]

ITTA has made repeated efforts to redirect regulatory policy toward "strengthening enforcement, rather than continuing to rely on prospective, prophylactic regulation."[60] ITTA and OPASTCO believe the present proceeding provides a pivotal opportunity to replace speculative, unnecessary regulation with a more market-oriented, pro-competitive approach which relies on enforcement. This proceeding offers a clear opportunity to transcend habits of the past, to take a singular, small step away from the historical path of expanding regulation.

The asserted fear of anticompetitive conduct is overstated, as is the deterrent value of the separate affiliate requirement. Terminating that requirement will not terminate the Commission's authority over independent ILECs. It will not terminate the positive requirements of the statutes regarding just, reasonable and non-discriminatory rates. Nor will it terminate the Commission's ability to enforce those statutes. It will not suspend federal antitrust laws or state consumer protection statutes.

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[58] Peter Huber, "Law and Disorder in Cyberspace," Oxford University Press (New York 1997) at 144.
[59] Commissioner Michael K. Powell Remarks of May 7, 1998 at 5.
[60] Commissioner Powell's Remarks of May 7, 1998, at 3.

What terminating the existing rule will do is make a start on reducing the amount of federal micromanagement now afflicting the interstate marketplace. It will add incremental importance to market demands, and decrease the importance of regulatory demands by that same increment. This may be the primary impediment to getting the Commission to terminate the rule, but it is an impediment that must be overcome – the sooner, the better for the Commission, the carriers, and the consumer.

Respectfully submitted,

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